No. 13,600

IN THE

United States Court of Appeals

For the Ninth Circuit

THE ANGLO CALIFORNIA NATIONAL BANK OF SAN FRANCISCO,
Appellant,

vs.

SCHENLEY INDUSTRIES, INC.,
Appellee.

CHARLES W. EBNOTHER, Trustee of the Estate of Hedgeside Distillery Corporation, Bankrupt,
Appellant,

vs.

SCHENLEY INDUSTRIES, INC., a corporation,
Appellee.

APPELLANTS' OPENING BRIEF.

FRANCIS P. WALSH,
HENRY GROSS,
JAMES M. CONNERS,
68 Post Street, San Francisco 4, California,
Attorneys for Appellant, Charles W. Ebnother, Trustee in Bankruptcy.

FREDERICK M. FISK,
111 Sutter Street, San Francisco 4, California,
Attorney for Appellant, The Anglo California National Bank of San Francisco.

CHICKERING & GREGORY,
111 Sutter Street, San Francisco 4, California.
Of Counsel.

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Subject Index

Table of Authorities Cited

Statutes

Texts

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APPELLANTS' OPENING BRIEF.

I.

JURISDICTION.

This is an appeal pursuant to the provisions of Section 24 of the National Bankruptcy Act, 11 U.S.C., Ch. 4, §47; 11 U.S.C.A. §47, from an Opinion and Order of the United States District Court for the

Northern District of California, Northern Division, signed and filed August 18, 1952 (R. 78).

Said Opinion and Order is an affirmation on a review by the United States District Court, Honorable Dal M. Lemmon, District Judge, of an order of the Referee in Bankruptcy, dated January 10, 1952, granting the appellee, Schenley Industries, Inc., the right to reclaim or obtain immediate possession from the Trustee in Bankruptcy of certain barrels of grain spirits stored on the premises of the bankrupt, Hedgeside Distillery Corporation, at the time of bankruptcy. The appellee, in its reclamation petition (R. 3), named The Anglo California National Bank of San Francisco, a national banking association, a creditor, and Charles W. Ebnother, the Trustee in Bankruptcy, as respondents. Answers were filed to said reclamation petition by each of said respondents opposing said petition (R. 9 and 12), the matter was tried before the Referee in Bankruptcy, and a review of the said Referee's Order by said District Judge was obtained pursuant to the provisions of Section 39c of the National Bankruptcy Act, 11 U.S.C., Ch. 5, §67; 11 U.S.C.A. §67 (R. 43 and 78).

II.

STATEMENT OF THE CASE.

This appeal involves the construction of three California statutes, that is, (a) Section 3440 of the California Civil Code, (b) Section 3440.5 of the

same Code, and (c) the Uniform Warehouse Receipts Act as enacted in California (Deering's Gen. Laws, Vol. 3, Act 9059, §58). These statutes have to do with the conclusive presumption of fraud in the case of the transfer of personal property where the possession or control remain with the transferor, as such laws are more particularly construed in connection with a transfer of grain spirits produced and stored by a distiller in its own warehouse.

Schenley Industries, Inc. (hereinafter referred to as "Schenley"), the appellee, purchased the grain spirits, here the subject of litigation, from the bankrupt, Hedgeside Distillery orporation (hereinafter referred to as "Hedgeside"), but left said grain spirits in the bankrupt's possession in its internal revenue bonded warehouse located upon the premises of said distiller and owned, used and operated by it as a *convenience* to it in the production and distribution of grain spirits.

Schenley, upon receiving from the bankrupt, invoices covering the sale of said grain spirits paid for same and received as evidence of its ownership documents purporting on their face to be "warehouse receipts". A typical copy of such documents appears as Petitioner's Exhibits 43, 52, 53 introduced in evidence in this case. Copies of said documents were kept by the bankrupt at its principal place of business, an office building located on the distillery premises at Napa, a truck and a half distant from the warehouse buildings in which the grain spirits in

question were stored, but no copies were kept under the roof of or "at the warehouse" in which the grain spirits in question were stored.

The general creditors of the bankrupt, represented here by one of the appellants, have invoked the provisions of Section 3440 of the California Civil Code and urge that all transfers to Schenley of the above mentioned grain spirits were void as to them because of Schenley's failure to take physical possession of the goods. The applicable portions of said Section are as follows:

> "§3440. [Transfers of particular personal property without delivery: Conclusive presumption of fraud: Transfers to which section not applicable: Transfers in bulk: Transfers under direction of court, etc.] Every transfer of personal property, other than a thing in action, or a ship or cargo at sea or in a foreign port, and every lien thereon, other than a mortgage, when allowed by law, and a contract of bottomry or respondentia, *is conclusively presumed if made by a person having at the time the possession or control of the property, and not accompanied by an immediate delivery, and followed by an actual and continued change of possession of the things transferred, to be fraudulent, and therefore void, against those who are his creditors while he remains in possession,* and the successors in interest of such creditors, and against any persons on whom his estate devolves in trust for the benefit of others than himself, and against purchasers or encumbrances in good faith subsequent to the transfer; . . . " (Italics ours.)

Schenley seeks to escape the application of the above law by the general creditors on two purported grounds. First, it contends that under the case law applicable in this jurisdiction grain spirits stored in a United States Internal Revenue Bonded Warehouse are not subject to Section 3440. Secondly, it contends that even if said Code section did apply the storage of grain spirits is excepted from said Code section by Subsection 3440.5 of the California Civil Code, which Subsection reads as follows:

> "§3440.5. [Same: Limitation on application of rule: Goods for which warehouse receipt has issued: Necessity for retention of copy.] Section 3440 of this code shall not apply to goods in a warehouse where a warehouse receipt has been issued therefor by a warehouseman as defined in the Warehouse Receipts Act, and a copy of such receipt is kept at the principal place of business of the warehouseman and at the warehouse in which said goods are stored. Such a copy shall be open to inspection upon written order of the owner or lawful holder of such receipt."

In order for the transactions with Schenley to fall within the provisions of the foregoing subsection it is necessary to show two things, which appellants contend the record below falls short of proving, i.e., first, that a warehouse receipt was issued for the goods sold "by a warehouseman as defined in the Warehouse Receipts Act"; and, secondly, that a copy of such warehouse receipt was kept not only at the

principal place of business of the warehouseman but "at the warehouse in which said goods are stored".

The California Warehouse Receipts Act (Deering's Gen. Laws, Vol. 3, Act 9059, §58) defines a warehouseman as follows:

> "'Warehouseman' means a person lawfully engaged in the business of storing goods for profit."

As we shall point out in our argument later, Hedgeside, the bankrupt, was not a warehouseman as defined by said Act, as it was not "lawfully engaged in the business of storing goods for profit". It charged merely a nominal monthly rental far below the rates charged by public warehousemen subject to regulation by the California Public Utilities Commission. The charges were in fact approximately one-half those made by regulated public warehouses (R. 884-886, Resp. Bank's Ex. 35). The evidence is uncontradicted that the monthly rental charges have remained the same notwithstanding expenses have risen precipitously and prices generally throughout the country have doubled and trebled. There is no evidence that at the time of establishing said charges, or at any other time, was there any *intent* on the part of the bankrupt to make a profit on the storage operation.

The issues, therefore, involve merely the construction of California statutes and may be summarized as follows:

1. Does Section 3440 of the California Civil Code apply to a transfer of grain spirits stored by the producer in bond in California?

2. Was Hedgeside a "warehouseman" as defined by the California Warehouse Receipts Act and, accordingly, within Section 3440.5 of the Civil Code?

3. Were copies of the receipts issued to Schenley by Hedgeside, in lieu of delivery and change of possession, kept "at the warehouse" as required by Section 3440.5?

There is no dispute as to the operative facts as the Court below found (R. 95). The issues to be resolved raise solely questions of law.

III.

SPECIFICATION OF ERRORS RELIED UPON.

We have heretofore filed with this Court under date of January 15, 1953, a "Statement of Points on Which Appellants Intend to Rely on Appeal". All of said errors flow from and are the result of the Court's basic errors, which we list as follows:

1. The Court erred in holding that the bankrupt, Hedgeside Distillery Corporation, was "engaged in the business of storing goods for profit" within the meaning of the California Warehouse Receipts Act.

2. The Court erred in holdng that storage of alcoholic products in an Internal Revenue Bonded Warehouse was a sufficient change of possession to avoid the effect of Section 3440 of the California Civil Code.

3. The Court erred in holding that copies of Schenley's "warehouse receipts" were kept "at the ware-

house'' within the meaning of Section 3440.5 of the California Civil Code.

4. The Court erred in holding that Schenley was entitled to the immediate possession of 4484 barrels of grain spirits produced by Hedgeside, sold by Hedgeside to Schenley, and in Hedgeside's possession in its Internal Revenue Bonded Warehouse as of the date of bankruptcy.

5. The Court erred in not holding that Hedgeside was not a ''warehouseman'' as defined by the California Warehouse Receipts Act, that storage of alcoholic products in an Internal Revenue Bonded Warehouse is not a sufficient change of possession to satisfy Section 3440 of the California Civil Code, and that copies of Schenley's receipts were not kept at the warehouse within the meaning of Section 3440.5 of the California Civil Code.

6. The Court erred in not holding that the transfer of said 4484 barrels of grain spirits from Hedgeside to Schenley was void as to the creditors of Hedgeside (represented by appellant, Charles W. Ebnother, Trustee in Bankruptcy) because there was not an immediate and continued change of possession from Hedgeside to Schenley as required by Section 3440 of the California Civil Code.

7. The Court erred in not holding that Schenley's reclamation petition should be denied as to said 4484 barrels of grain spirits, and that the Trustee was entitled to said 4484 barrels for equitable distribution to the creditors of Hedgeside.

IV.

ARGUMENT.

A. HEDGESIDE WAS NOT AND DID NOT EVEN PURPORT TO BE A "WAREHOUSEMAN" AS DEFINED BY THE WAREHOUSE RECEIPTS ACT.

For the convenience of this Court, we point out that most of the Opinion and Order (R. 78-132) of the Honorable Dal M. Lemmon, being reviewed here, is irrelevant as the appellants have abandoned several of the issues raised in the hearing before the Referee and reviewed by District Judge Lemmon. For example, there is now no contest as to any of the production of the bankrupt's subsidiary (Franciscan Farm and Livestock Corporation, sometimes known as Mountain View) or of the production of *whiskey,* which requires aging, of either the bankrupt or its subsidiary, nor is there any review requested on whether or not the subsidiary was the *alter ego* of the bankrupt, nor of the question of whether or not the Appellant Bank obtained prior ownership rights to those of Schenley because of the issuance by the bankrupt of duplicate warehouse receipts. The issue to be reviewed has now been reduced to the single question of whether or not the transfers of "grain spirits" produced by the bankrupt and stored in its warehouse on the distillery premises were fraudulent and void as to creditors by reason of Section 3440 of the California Civil Code. The pertinent portions of the District Judge's Opinion and Order, therefore, now consist of his preliminary statements, sections numbered 1, 2, 3, 4, and 6 (R. 78-82,

94-95); "The Real Basic Issue," section numbered 13 (R. 115-124); the effects of storing in an Internal Revenue Bonded Warehouse, section numbered 14 (R. 124-130); and the last five paragraphs of "Conclusion," section numbered 15 (R. 131, 132).

It is undisputed that the barrels of grain spirits, which are the subject of this litigation, were produced by Hedgeside on its distillery premises at Napa, were stored in its warehouse operated as an internal revenue bonded warehouse located on its premises, were sold to Schenley for a valuable consideration, and were left in said warehouse continuously until and including the date of bankruptcy. Schenley received, at the time of purchase, written documents purporting on their face to be "warehouse receipts" (Pet. Ex. 43, 52 and 53) covering said grain spirits but failed to take physical possession thereof (Referee's Findings of Facts, Findings 3, 4; R. 17-25). Presumptively, since the transfer from Hedgeside to Schenley was "not accompanied by an immediate delivery followed by an actual and continued change of possession of the things transferred," said transfer "is conclusively presumed fraudulent and void as against the transferor's creditors while he remains in possession and the successors in interest of those creditors." California Civil Code, Sec. 3440.

To said Section 3440 the California Legislature has made an exception limiting its application:

> "§3440.5. [Same: Limitation on application of rule: Goods for which warehouse receipt has

> issued: Necessity for retention of copy.] Section 3440 of this code shall not apply to goods in a warehouse where a warehouse receipt has been issued therefor by a warehouseman as defined in the Warehouse Receipts Act, and a copy of such receipt is kept at the principal place of business of the warehouseman and at the warehouse in which said goods are stored. Such copy shall be open to inspection upon written order of the owner or lawful holder of such receipt."

To fall within the foregoing exception one must among other things qualify as a warehouseman as defined in the California Warehouse Receipts Act (Deering's Gen. Laws, Vol. 3, Act 9059, §58), which definition is as follows:

> " 'Warehouseman' means a person lawfully engaged in the business of storing goods for profit."

From the foregoing statutes, it is apparent that in order for Schenley to have escaped the application of Section 3440 it must have proved (1) that copies of the receipts obtained were kept at Hedgeside's principal place of business, (2) that copies were kept at the warehouse, (3) that Hedgeside was *lawfully* engaged in storing, and (4) that it was engaged in the *business* of storing goods *for profit.* Since possession of the grain spirits in question was with the Trustee in Bankruptcy at the time Schenley filed its petition for reclamation, the general burden of proof of showing the right to immediate possession fell upon Schenley (In *re Byrne,* 32 F.2d 189 (2d Cir. 1929); *In re Union Food Stores Co.,* 3 F.2d 736 (7th

Cir. 1925)) as possession in the Trustee gave rise to a presumption of ownership in the bankrupt. *In re Heintz-Merkle & Co.,* 1 F. Supp. 531, 536 (D.C. Penn. 1932), aff'd. 61 F.2d 519 (3d Cir. 1932); *Remington on Bankruptcy,* 4th Ed., Vol. 5, §2467. In addition, in order to escape the effects of Section 3440, Schenley was obligated to prove that it fell within Section 3440.5 above or that the four above requirements had been met. Section 3440.5 is an exception to and limits the scope of Section 3440. Therefore, according to the well-established principle of statutory construction, one asserting the exception must show strict compliance. *Canadian Pacific Ry. Co. v. United States,* 73 F.2d 831, 834 (9th Cir. 1934).

In apparent recognition of this burden, Schenley adduced evidence showing (1) that copies of the receipts obtained were kept at the bankrupt's principle place of business but it failed to produce satisfying evidence, (2) that copies were kept at the warehouse, and (3) that Hedgeside was lawfully engaged in storing, or any evidence (4) that it was engaged in the business of storing goods for profit.

Notwithstanding the failure or even attempt of Schenley to meet the burden of proof required to establish the exception, there is uncontradicted evidence in the record below that Hedgeside (1) did not advertise or solicit storage (R. 869; Referee's Findings of Fact, Finding 6, R. 29), (2) did not fix rates which could yield an excess of storage income over storage expense (R. 884-886, Resp. Bank's Ex. 35),

(3) did not attempt to fix rates which could yield such excess (R. 878), (4) refused to store for anyone who had not purchased its production or entered into a bottling contract with it (R. 873-874, 886-887), (5) did not file its storage rates with the California Public Utilities Commission (Resp. Bank's Ex. 47), and (6) established storage charges less than 50% of those charged by public warehouses throughout the state (R. 884-886; Resp. Bank's Ex. 35).

The undisputed facts below then are that Hedgeside never sought any warehouse business except where the goods stored were its own production or were to be serviced by it in some way, such as bottling. In fact, it refused to store unless the storage was incidental to its basic operation of distilling and bottling. It not only did not make a profit on its storing operation but it never made any effort to determine the results. The commercial Internal Revenue Bonded Warehouses in San Francisco and Stockton (not operated as part of a distillery), under the regulation of the California Public Utilities Commission, charged rates more than 100% higher than those charged by Hedgeside. This Court may take judicial notice (and the District Court and Referee below were in a similar position) of the fact that regulated public utilities are held to a return of less than 6%. Accordingly, if the rates charged by a regulated Stockton public warehouse are reasonable the rates of less than one-half charged by Hedgeside could not possibly represent a profit on its warehousing business. The rates

charged by Hedgeside were never changed from the inception of the company even though material and labor costs constantly rose generally throughout the country and particularly in California. Not only does the evidence show, without contradiction, that the warehousing business could not have been at a profit, but Mr. Logan's testimony, an officer and director of the bankrupt (R. 878), shows that there never was any *attempt* to make a profit. If you neither make a profit nor intend to make a profit you obviously cannot be in the business for profit.

In *Institute of Holy Angels v. Bender,* 79 N.J.L. 34, 74 Atl. 251 (N.J. 1909), the Court decided that a school is "not conducted for profit" within the meaning of the Tax Act involved when it appears that the charges for tuition and board are not fixed with the intention of yielding a profit over and above the actual cost.

In *Early v. Atkinson,* 175 F.2d 118, 122 (4th Cir. 1949), the Court held that the taxpayer's motive or state of mind determines whether a transaction was entered into for "profit" so as to make a loss incurred in the transaction deductible for income tax purposes.

Webster's New International Dictionary defines "profit" as "the excess of returns over expenditures in a given transaction or series of transactions;" also, "excess of income over expenditure, as in a business or any of its departments, during a given period of time."

According to the accepted rules of statutory interpretation, the words of the Legislature should be given their ordinary and usual meaning unless a different intent is shown. Also, statutes creating an exemption are strictly construed. Therefore, one would expect that the District Court would promptly have concluded from the clear and plain wording of the exemption and the undisputed facts that the bankrupt was not a warehouseman as defined by the California Warehouse Receipts Act, as it was not engaged in the business of storing goods for profit. However, not even Court decisions holding the word "profit" to mean an excess of receipts over expenditures (*Fairchild v. Gray,* 136 Misc. 704, 242 N.Y.S. 192) deterred the District Court from concluding that "profit" was synonymous with "charge" or "price".

The District Court in holding in his opinion that the bankrupt was engaged in the business of storing goods for profit (R. 117-122) did so by looking to the decisions of other jurisdictions and then referring to Section 57 of the Warehouse Receipts Act which indicates that the Act should be interpreted so as to produce uniformity with other states. In passing, we point out that California holds that its District Court of Appeal in construing the said Act should follow the court of last resort in this state rather than the decisions of some other state. *McMullins v. Lyon Fireproof Storage Co.*, 74 Cal.App. 87, 239 Pac. 422 (1925). Not only that but the courts of most states must have acted in a similar manner, otherwise there

would be no occasion for Vol. 3 of Uniform Laws Annotated covering warehouse receipts, consisting of some 273 pages and a multitude of decisions of the various states which have adopted the Uniform Warehouse Receipts Act in which they differ from one another in their respective interpretations of the various provisions of said Act.

One of the decisions the District Court relied on in this connection is the case of *Fidelity & Deposit Co. v. State of Montana,* 92 F.2d 693 at 696 (9th Cir. 1937). This case is not in point as there was no contested issue as to whether or not Chatterton & Son was a public warehouseman as defined by the Warehouse Receipts Act, as that fact was not questioned. In this connection, the Ninth Circuit Court noted, at page 696:

> "The application was for a public warehouseman's bond. *That Chatterton & Son was a public warehouseman within the general meaning of the term is not questioned.* A storage and handling charge was regularly exacted from all those using the warehouse facilities and negotiable warehouse receipts were uniformly issued. 67 C.J. 443." (Italics ours.)

The only comment by the District Court on the case at bar was a reference to the last two sentences of the above quotation. (R. 120.)

Not only did the decision not involve an interpretation of the definition of a warehouseman in the Uniform Warehouse Receipts Act but the Court actually

referred to 67 C.J. 443 which defines a public warehouse as follows:

> "A 'public warehouse' is a place that is held out to the public as being one where any member of the public, who is willing to pay the regular charges, may store his goods and then sell or pledge them by transferring the receipt given him by the keeper or manager."

The undisputed evidence below (R. 29 and 869) is that Hedgeside did not hold itself out to store for the public generally, nor did it solicit storage. Therefore, for an additional reason the above decision is in no sense a precedent in this case.

The District Court next cited (R. 121) the case of *New Jersey Title Guaranty & Trust Co. v. Rector,* 76 N.J. Eq. 587, 75 Atl. 931 (1910). This decision reversed the trial court's order sustaining a demurrer to a complaint in interpleader which had failed to set forth the *amount* of storage charges exacted. The New Jersey Court referred to Section 58 of the Warehouse Receipts Act treating with the definition of warehouseman and then said that the bill of complaint "alleges that the complainant is conducting the business of running safe deposit vaults and warehousing valuable goods and chattels for hire, which sufficiently describes 'warehouseman' as defined by the Act,". Here a pleading question only was involved and the complainant had alleged that it was "in the business" of running safe deposit vaults and warehousing goods. "Business," in the commonly accepted meaning of

the word, means an occupation engaged in for profit. 5 *Words and Phrases* at pp. 998-1005. Again, the case is not in point as the question of profit or no profit was not placed in issue.

The case of *New Jersey Mfg. Ass'n. Fire Insurance Company v. Galowitz,* 150 Atl. 408 (N.J. 1930), relied on by the District Court (R. 122) is likewise not in point. In this case the defendant, a garage-keeper for hire, was sued in connection with the destruction by fire of certain automobiles stored in his garage. There was no contested issue as to whether the defendant was engaged in the garage business *for profit.* Therefore, the question involved was not litigated. Any garageman storing cars for hire would be presumed to be in the business for profit unless surrounding circumstances pointed otherwise. In the case at bar the uncontradicted proof is that the bankrupt neither made nor intended to make a profit out of his warehousing business.

In like manner, the case of *E. V. Webb & Co. v. Friedberg,* 189 N.C. 166, 126 S.E. 508 (1925), cited by the Court (R. 122) is not in point. In this case the North Carolina Court, after making the statement at p. 509 quoted by Judge Lemmon (R. 122), made the following statement:

> "The receipts *and admitted evidence* shows that the concerns are warehousemen and the concerns dealt with the public as such." (Italics ours.)

In the case at bar the receipts given and the undisputed evidence prove that Hedgeside did not deal

with the public generally and was not in the business for profit.

Not only did the District Court erroneously construe Section 3440.5 to mean that one may be a warehouseman as defined by the California Warehouse Receipts Act if a charge for storage is made regardless of whether one is engaged in the business for profit, as such term is commonly understood, and justify its conclusion upon decisions of jurisdictions other than California (which, as we have just pointed out, did not involve the issue of the profit), but said District Court discarded two California cases on the grounds that they were not in point (R. 120) by stating that "for profit" was used interchangeably in said cases with "to pay for that service" and "charge for storage." We submit that this is a wholly erroneous interpretation of said decisions.

The first case so treated is *Sinsheimer v. Whitely,* 111 Cal. 378, 43 Pac. 1109 (1896) (R. 119). In that case there was a controversy as to whether a particular document was a warehouse receipt or merely a weighing tag. The alleged warehouseman had made no charge for storage. The District Court below quoted a portion of said opinion as follows:

> "A warehouse receipt has been defined to be a written contract between the owner of the goods and the warehouseman, the latter to store the goods and the former to pay for that service. (*Hale v. Milwaukee Dock Co.,* 29 Wis. 488; 9 Am. Rep. 603.) Perhaps some of the terms of this contract may be implied (see forms of such re-

ceipts construed in *Lowrie v. Salz,* 75 Cal. 349, and *Bishop v. Fulkerth,* 68 Cal. 607); but surely there ought to be something on the face of the instrument to indicate that a contract of storage has been entered into; our statute on the subject requires that much (Stats. 1877-78, p. 949, sec. 5); the language in the papers here, 'Weighed for F. J. Silva forty sacks beans,' no more signifies that the paving company received or held the beans as a warehouseman than that it bought or sold the same, or shipped them to a distant port; on their face they plainly are not warehouse receipts. (*Cathcart v. Snow,* 64 Iowa 584; *Robson v. Swart,* 14 Minn. 371; 100 Am. Dec. 238.) But it is said that the tickets were the only vouchers issued by the defendant company, and hence must be treated as warehouse receipts. Rather, it seems to us, that circumstance tends to show that said company was not a warehouseman at all in the sense which the law attributes to that term—an inference corroborated by the fact that it makes no charge for storage. *It is only persons who pursue the calling of warehousemen—that is, receive and store goods in a warehouse as a business for profit—that have power to issue a technical warehouse receipt, the transfer of which is a good delivery of the goods represented by it.* (*Shepardson v. Cary,* 29 Wis. 42; *Bucher v. Commonwealth,* 103 Pa. St. 534; Edwards on Bailments, sec. 332.)" (Italics ours.)

From the portions of the opinion quoted above, the District Court below erroneously concluded (R. 120) that the expressions "to pay for that service," "charge for storage," and "for profit" are used inter-

changeably. It is difficult to determine why this erroneous interpretation of the opinion occurred. The Court in the above decision did hold that the person in question was not storing for profit if he charged nothing, but he certainly did not hold, say, or intimate that one becomes a warehouseman by merely charging something, however nominal the amount. Of course, profit does not exist if no storage charge whatsoever is made, as the California Supreme Court held, but, from the foregoing we submit that the implication is that a charge which is profitable or intended to be profitable should be made to qualify as a warehouseman under the Act and not merely that some insignificant and unprofitable charge be made as the District Court below held.

The above discussion applies equally to the other California case cited (R. 120) by the District Court, *Harry Hall & Co. v. Consolidated Packing Co.,* 55 C.A.2d 651, 131 P.2d 859 (1942). This case involved a raisin packer who sold raisins to a buyer. The packer issued what purported to be a warehouse receipt for the goods which the buyer in turn assigned to the plaintiff. On the refusal of the packer to deliver, suit resulted. The goods were at all times stored on the packer's premises and no storage charges were made. Noting that the packer received no storage charges, the Court held that the document in question could not be a warehouse receipt, citing *Sinsheimer v. Whitely, supra.* There is no intimation in the opinion that the court, contrary to the language of the Ware-

house Receipts Act, would have held the packer to be a warehouseman if a nominal storage rate too low to produce a profit had been charged.

While we do not contend that the above California cases expressly hold that a profitable storage charge must be made to qualify as a warehouseman under the California Warehouse Receipts Act, we do contend that the plain wording of the Act requires such a construction and if any implication is to be drawn from the above cases it is that the purported warehouseman must have at least *intended* to make a profit.

The District Court concedes that the California decisions hold that one does not qualify as "warehouseman" in California where no charge is actually made but appears to hold that *any* charge however small meets the requirements of the Act. If so, Section 3440 has been completely abandoned as any manufacturer or producer may build a building to house its production, sell and store same, issue a receipt for a nominal charge, and thereby deprive creditors of the benefits of Section 3440.

We respectfully submit that that should not be and is not the law. We know of no decision in California or elsewhere that has reached that conclusion.

B. GOODS STORED IN AN INTERNAL REVENUE BONDED WAREHOUSE ARE NOT EXEMPTED FROM THE APPLICATION OF THE CALIFORNIA STATUTE, SECTION 3440.

§3440 of the California Civil Code provided at the time of bankruptcy of Hedgeside that every transfer of personal property made by a person having possession or control of the property is conclusively presumed fraudulent unless accompanied by an immediate delivery and followed by an actual and continued change of possession, subject to certain exceptions. Among the exceptions are choses in action and a ship or cargo at sea or in a foreign port. Another exception applies to transfers of wines and the pipes and casks in which the wine is contained, provided the transfer is recorded. There is and was then no exception applicable to distillers generally or to transfers of whiskey or grain spirits. In *Stewart v. Scannell,* 8 Cal. 81 (1857), a case which has never been overruled, the California Supreme Court invoked the statute which was a predecessor to §3440 to defeat a sale of whiskey, the whiskey being retained by the vendor in its warehouse and warehouse receipts being issued therefor to the purchaser.

Notwithstanding the foregoing case, the District Court below held that storage by a distiller in an internal revenue bonded warehouse, owned and operated by the distiller, was sufficient to avoid the application of §3440 whether or not warehouse receipts for the spirits or whiskey were issued by a "warehouseman" as defined by the California Warehouse Receipts Act (R. 124). In short, according to

the position of the District Court below, it is unnecessary to determine whether or not Hedgeside was a warehouseman, since storage by it of its grain spirits production in its internal revenue bonded warehouse avoids §3440 in any event.

No statutory language was invoked to support this result, and our position is that under the plain terms of §3440 its provisions apply notwithstanding storage is in bond. If further support were needed, the fact that the legislature adopted some exceptions but none for transfers of whiskey or grain spirits shows that no exception as to the latter categories of goods was intended, whether or not storage is in bond, under the familiar maxim *expressio unius est exclusio alterius,* a principle particularly applicable to the construction and interpretation of statutes. *Miller v. Commonwealth,* 180 Va. 36, 21 S.E.2d 721 (1942).

Our contention that the legislature never intended an exception to apply to storage of whiskey or grain spirits in bond is furthed fortified by the subsequent history of §3440. In 1951 the California legislature amended the section to provide a further exception with respect to brandy. Stats. 1951, Ch. 1687, §2. The exception applicable to brandy now provides:

> "This section (§3440) shall not apply to any of the following:
>
> (d) Wines or brandies in the wineries, distilleries, or wine cellars of the makers or owners of the wines or brandies, or other persons having possession, care, and control of the wines or brandies, and the pipes, casks, and tanks in which

> the wines or brandies are contained, if the transfers are made in writing and certified and verified in the same form as provided for chattel mortgages, and if the transfers are recorded in the book of official records in the office of the county recorder of the county in which the wines, brandies, pipes, casks, and tanks are situated."

Certainly there was no reason to adopt an exception with respect to brandy if storage in an Internal Revenue Bonded Warehouse automatically creates an exception, as the reasons for storage of brandy in bonded warehouses are fully as compelling as those for storing whiskey and grain spirits, since the rate of tax is the same (26 U.S.C.A. §2800(a)(1)),[1] and all distilled spirits, including brandy, must be deposited in a bonded warehouse to escape immediate imposition of the tax. 26 U.S.C.A. §2800(b)(1) and (2); 26 U.S.C.A. §2879.

The conclusion of the District Court below was based on an analysis of cases from other jurisdictions applying dissimilar statutes as applied to dissimilar facts. The Court's opinion was based primarily on *Taney v. Penn Bank,* 232 U.S. 174, 34 S. Ct. 288, 58 L. Ed. 558 (1914) (R. 125). That case is an early case excusing a change of possession in the case of distilleries operating in Pennsylvania. However, the

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[1]Grape brandy is included within the definition of "distilled spirits" in §2800(a)(1), 26 C.F.R. Part. 183.1(g), which defines distilled spirits as follows: "Distilled spirits" shall mean that substance produced by the distillation of fermented grain, molasses, or other materials, commonly known as spirits, whiskey, rum, gin, brandy, etc., but shall not include alcohol.

case purported to apply Pennsylvania law, and not some federal law as the District Court below erroneously implied (R. 129). In this connection, the U. S. Supreme Court in the *Taney* case held (232 U.S. at 180):

> "The legal effect of the transaction depends upon the local law."

Since the District Court below heavily relied on the last-cited case and the opinion below in the same case (*Taney v. Penn Bank,* 187 Fed. 689 (3d Cir. 1911)), we will analyze the case in some detail in the light of the contrasting California law which must control the result here.

The *Taney* case involved a pledge of whiskey. There was no transfer of physical possession, but the pledgor issued warehouse receipts to the pledgee, the whiskey being stored in an internal revenue bonded warehouse. The Supreme Court held that *under the law of Pennsylvania* the pledgee prevailed over the trustee in bankruptcy of the pledgor despite said pledgee's failure to take physical possession.

The Supreme Court noted that by *Pennsylvania law* a transfer of possession is not required when the usages of the particular trade or business are such that those engaged in the business do not regard a physical delivery as customary or essential, or where the inherent nature of the transaction and the attendant circumstances are such as to preclude the possibility of a delivery by the vendor. 232 U.S. at 181.

As to usage, suffice it to say that the California statute makes no such exception, no California case has been cited as even *intimating* that such an exception exists, and the appellants' contention in *Stewart v. Scannell, supra,* that commercial convenience and expediency would best be served by recognizing constructive changes of possession in certain instances was rejected by the California Court. In the *Scannell* case, the vendor sold certain barrels of whiskey but retained possession as a warehouseman, issuing warehouse receipts to the vendee. A storage charge was made. The California Court held, nevertheless, that the transaction was void under the California statute as to creditors of the vendor.

An additional point considered relevant by the U. S. Supreme Court under *Pennsylvania law* was the "joint custody" of the whiskey by the warehouse proprietor and the government storekeeper-gauger. Under the Internal Revenue laws, the government employee can and does refuse to permit physical removal of whiskey or spirits from the proprietor's warehouse until taxes due are paid. However, his responsibility ends when such taxes are paid and even during storage he is unconcerned with questions of ownership, storage charges and the like. This joint control or custody was considered of some significance in excusing changed possession under Pennsylvania law, but is of no importance whatsoever under California law. Two California cases control on this point. In each of said cases it was easier to contend that there was "divided possession" or "joint

custody" than it is in the case of Hedgeside and a storekeeper-gauger; notwithstanding, Section 3440 was held to apply.

The first case is *Newell v. Desmond,* 63 Cal. 242, 15 Pac. 369 (1883). In that case two partners were in joint possession of certain goods belonging to the partnership. One partner purported to sell his interest in the goods to a third person without any transfer of possession. The Court held the transfer was void as to creditors of the transferor despite the transferor's divided possession with his partner.

The second case is *Haster v. Blair,* 41 C.A.2d 896, 107 P.2d 933 (1940). In that case personal property was in the divided possession of two tenants in common. One tenant attempted to transfer his interest to a third person without a transfer of possession. The Court held the transfer void as to creditors despite the shared possession of the transferor. It will be seen from the above two cases that any "joint custody" between Hedgeside and a government storekeeper-gauger is entirely irrelevant in applying Section 3440 to the attempted transfer from Hedgeside to Schenley.

However, still another factor was considered by the U. S. Supreme Court as significant under Pennsylvania law in upholding the transfer in question. The Court held that there were certain difficulties in the inherent nature of the transaction and attendant circumstances so that by Pennsylvania law delivery was excused. Here the Court referred to a finding that

before delivery could be made a tax had to be paid, and that the goods were not ready for delivery at the time of pledge since they had to be put in a bonded warehouse to complete the necessary aging process. 232 U.S. at 185.

The California legislature may well have had the same problem in mind when it adopted the present statutory exception to the application of §3440 in the case of brandy.[2] But the remedy in case of hardship is to seek revision of the statute, as, of course, has been done with respect to some products. Absent an exception spelled out by statute, §3440 has been rigorously applied despite the presence of factors relied on by the Supreme Court as excusing a change under the law of Pennsylvania.

It is true that in California in the case of bulky articles or growing crops, when immediate delivery is well nigh impossible, a *delay* in transferring possession is excused. See, e.g., *Dubois v. Spinks,* 114 Cal. 289, 46 Pac. 95 (1896); *Westcott v. Nixon,* 132 Cal.App. 490, 23 P.2d 75 (1933). But this principle does not apply to spirits or whiskey, whether in barrels or bottles. *Guthrie v. Carney,* 19 Cal.App. 144, 152, 124 Pac. 1045 (1912) (*held,* wines and liquors in barrels, demijohns and bottles not a bulky article so as to excuse delivery). Furthermore, no California case intimates that the avoidance of tax payments or other expense or the necessity for aging excuses

[2]No doubt distillers of whiskey and grain spirits would have sought a similar exemption had their business been of as much importance in California as are the grape and brandy industries.

immediate delivery as was indicated in dicta in the *Taney* case. Even if California law were identical, which it is not, the *Taney* case would have no application. In the first place, the merchandise now in dispute consists of grain spirits which do not require aging. Furthermore, other warehouses were so close to Hedgeside that whiskey and spirits could be stored elsewhere within 72 hours so that tax payments could be avoided. This was not true on the facts of the *Taney* case, and the evidence in the present case showed that some whiskey or spirits produced at Hedgeside actually *was* stored at other warehouses within the 72 hour period (R. 887-891).

Finally, assuming for argument's sake that some delay on the present facts would be permitted under California law (which is not the case) the delay in the case at bar has continued far too long a time. This principle is well illustrated in the rule applicable to growing crops. In that situation, although an *initial* delay is permitted, once the crops have matured immediate delivery must be made. *Westcott v. Nixon,* 132 Cal.App. 490, 23 P.2d 75 (1933). On the facts of the present case, although some initial delay may have been desirable from Schenley's standpoint, it actually did take delivery of some whiskey and spirits from Hedgeside purchased under the same production contracts as the merchandise now in dispute. Since it was feasible to make partial withdrawals, it was equally feasible to withdraw the whole. Certainly Schenley cannot be heard to say that delivery should be excused simply because it did not happen to suit

its convenience to take delivery of *all* of the spirits now in dispute.

Finally, according to the clear language of the California statute (Section 3440) there is no requirement that creditors be in fact misled by the seller's possession in order to invoke said statute. The *Taney* case discussion of this point is completely irrelevant under California law. *Joseph Herspring Co. v. Jones,* 55 Cal.App. 620, 203 Pac. 1038 (1921).

The second case cited by the Court below (R. 129) as purportedly supporting its position that §3440 does not apply as to goods stored in an internal revenue bonded warehouse is *Merchants Nat. Bank v. Roxbury Distilling Co.,* 196 Fed. 76 (D.C. Md. 1912). The Court in that case points out that a change of possession is excused in Maryland in the case of distillers because of a special Act expressly making distillers "warehousemen" under the Maryland Warehouse Receipts Act. The Court added that the same result would be reached independently of said statute, but in so doing it cites the *Taney* case, which, as above noted, depends on decisions treating a retention of possession as merely a badge of fraud which can be overcome by showing hardship, etc. This rule, of course, does not apply under the law of California which must control the result here, since by California law a retention of possession is *conclusively* presumed fraudulent.

It is respectfully submitted that based on the plain language of §3440 of the California Civil Code, a deposit of grain spirits in an internal revenue bonded

warehouse does not avoid the effect of the statute, and the District Court's holding to the contrary must be overruled.

The District Court below threw out Section 3440 because of the "Government's tight control over distilleries" (R. 124) and the "Government's heavy hand" as displayed in the *Taney* case (R. 125). He emphasized "joint custody" between the storekeeper-gauger and the proprietor (R. 126) and that the *Taney* case related to Federal statute and not Pennsylvania law (R. 129). The last statement is a clear misconstruction of the import of that case as we have already pointed out. It makes clear, however, the fact that the District Court below failed to recognize his obligation to determine the expressed intent of the California legislature as derived from the words used in the light of the California law when such words were used. The *Taney* case involved a Pennsylvania statute quite different from our California statute which has been construed by our Courts and amended by our legislature in a manner inconsistent with the *Taney* case decision. It, therefore, is no precedent to be followed in this case. The government storekeeper-gauger was under no obligation to control or keep track of ownership. He was only concerned with physical possession and the payment of tax. There are many internal revenue bonded warehouses in California qualified as public warehouses in no way connected with a distillery. In fact, we know of no whiskey distilleries in California since the demise of Hedgeside. What better proof is there that

the storekeeper-gauger has no knowledge or interest in ownership than the fact that over a period of years the bankrupt borrowed several hundred thousand dollars secured by purported warehouse receipts on spirits that had already been sold. The Government's tight control over distilleries may well protect its tax but it certainly offers no protection to creditors. A bonded warehouse under the lock and key of the government may even offer an impedance to a creditor determining whether his receipt is worthless as security.

C. NO COPIES OF HEDGESIDE'S WAREHOUSE RECEIPTS WERE KEPT AT ITS WAREHOUSE AS REQUIRED BY SECTION 3440.5 OF THE CALIFORNIA CIVIL CODE.

As earlier stated, in addition to being a "warehouseman" as defined by the California Warehouse Receipts Act, copies of the warehouse receipts must be kept "at the warehouse" for Section 3440 of the California Civil Code to be avoided by showing compliance with the exception contained in Section 3440.5 of said Code.

Schenley failed to come within the provisions of Section 3440.5 due to the fact that Hedgeside could not qualify as a "warehouseman" within the meaning of the Warehouse Receipts Act. That failure alone calls for reversal.

Nevertheless, Schenley's claim should be defeated, and the Court's order below reversed even if it had proved that Hedgeside was a "warehouseman", which

it did not, since it failed to prove that copies were kept "at the warehouse."

The proof shows (R. 711) that all copies were kept in a safe in an office building located a truck and a half away from the warehouse building (R. 718). No attempt was made by either Hedgeside or Schenley to comply with the provisions of Section 3440.5 which requires that copies be kept "at the warehouse" as well as at the principal place of business.

Since Section 3440.5 must be literally and strictly construed, *Canadian Pacific Ry. Co. v. United States, supra,* it is submitted that as an independent grounds of reversal of the order below this Court should hold that copies of Hedgeside's receipts were not kept "at the warehouse" as required by said Section 3440.5. The District Court's construction was just the reverse and therefore in error (R. 122-124).

D. HEFFRON v. BANK OF AMERICA NAT. TRUST & SAVINGS ASS'N., 113 F.2d 239 (9th Cir. 1940), HAS NO APPLICATION IN THE CASE AT BAR.

The District Court below, relying on the *Heffron* case above, held that Section 3440 no longer governs a case of the type this case presents (R. 115-117). That decision is no precedent in this case as it clearly involved a warehouseman engaged in the business of storing goods for profit. It dealt with the familiar operation of a "field warehouse" operated by the well-established business enterprise, the "Lawrence Ware-

house Company," a strictly warehouse business operated for a profit over a period of many years.

V.

CONCLUSION.

The gist of this case involves merely the proper construction and application of three statutes, viz., Sections 3440 and 3440.5 of the California Civil Code and the definition of "warehouseman" in the California Warehouse Receipts Act. There is nothing mysterious or ambiguous about the language of said three statutes. Their meaning is perfectly plain, and their application defeats Schenley.

In apparent recognition of the weakness of its position under the *statutes,* Schenley elected to rely on case authority from other jurisdictions having nothing whatsoever to do with Section 3440 or its effect, and distinguishable both on the facts and the law. Apparently the District Court was convinced and erroneously adopted Schenley's theory.

If Hedgeside may become a "warehouseman" merely by calling itself one, issuing documents purporting to be warehouse receipts and charging a nominal storage charge, then every other manufacturer in the state may do the same. If Hedgeside may avoid Section 3440 merely because it suits the convenience of itself or its customers to leave sold goods on its premises, we have no doubt that other manufac-

turers will find equally valid arguments of convenience or expediency. Such a result means the end of Section 3440, requires a refusal to apply the plain language of the statute, and would produce not only an unlawful result here, but would create endless opportunities for future secret liens, frauds on creditors, and complications in the administration of bankrupts' estates.

We urge that the order of the Court below be reversed as to the barrels of spirits now in dispute and that Schenley's Reclamation Petition be dismissed.

Dated, San Francisco, California,
July 24, 1953.

Respectfully submitted,
FRANCIS P. WALSH,
HENRY GROSS,
JAMES M. CONNERS,
Attorneys for Appellant, Charles W. Ebnother, Trustee in Bankruptcy.
FREDERICK M. FISK,
Attorney for Appellant, The Anglo California National Bank of San Francisco.

CHICKERING & GREGORY,
Of Counsel.